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UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

IN RE: §
A'GACI, LLC § CASE NO. 19-51919-RBK
§ CHAPTER 11
DEBTOR § Hearing Date: 8/28/2019 @ 2:00 p.m.
§

OBJECTION OF THE UNITED STATES TRUSTEE TO DEBTOR'S MOTION
SEEKING ENTRY OF INTERIM AND FINAL ORDERS PURSUANT TO 11 U.S.C. §§
105, 361, 362, 363, 364 AND 507 (I) APPROVING POSTPETITION FINANCING, (II)
AUTHORIZING USE OF CASH COLLATERAL, (III) GRANTING LIENS AND
PROVIDING SUPERPRIORITY ADMINISTRATIVE EXPENSE STATUS, (IV)
GRANTING ADEQUATE PROTECTIONS, (V) MODIFYING AUTOMATIC STAY, (VI)
GRANTING RELATED RELIEF, AND (VII) SCHEDULING A FINAL HEARING

TO THE HONORABLE RONALD B. KING,
CHIEF UNITED STATES BANKRUPTCY JUDGE:

COMES NOW Henry G. Hobbs, Jr., Acting United States Trustee for Region 7 ("UST"), and objects to Debtor's Motion Seeking Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364 and 507 (I) Approving Postpetition Financing, (II) Authorizing Use of Cash Collateral, (III) Granting Liens and Providing Superpriority Administrative Expense Status, (IV) Granting Adequate Protections, (V)

Modifying Automatic Stay, (VI) Granting Related Relief, and (VII) Scheduling a Final Hearing.

The primary purpose of this chapter 11 bankruptcy case is to pay the pre-petition debt of Second Avenue Capital Partners, LLC (“Second Avenue”). Second Avenue entered this case with a purported \$6 million claim. It expects to be fully paid with interest and attorney’s fees. Based on current projections, however, this case may be administratively insolvent. Not only might the debtor not have funds to pay unsecured creditors in this case, it may not have sufficient cash to cover the costs of administration.

Under these circumstances, the Court should look very closely at the cost and the terms of the proposed financing. For example, the debtor did not need a \$10 million line of credit, it needed to borrow, at most, perhaps \$1 million to \$1.5 million. Because the \$200,000 closing fee is based on an inflated \$10 million loan request, the cost is out of proportion with the true borrowing need.

Given the facts of this case, this is also not a case where the Court should allow every “bell and whistle” to Second Avenue, which needed to lend this money to collect on its pre-petition debt. The Court should deny the Financing Motion unless Second Avenue agrees to the changes discussed below.

In support of this objection, the UST respectfully shows the Court the following:

Factual Background

1. A’GACI, LLC filed its first chapter 11 bankruptcy case on January 9, 2018. The Court entered an order confirming its plan of reorganization on July 27, 2018. The Court entered a final decree on April 15, 2019.
2. The debtor was unable to perform under its reorganization plan and filed a

second chapter 11 bankruptcy case on August 7, 2019. The debtor announced that it plans to close its remaining locations and complete going-out-of-business sales by the end of August 2019. In support of this plan, the debtor has filed a motion to reject all 55 of its store leases as of August 30, 2019. Docket No. 58.

3. As of the filing case, the debtor purportedly owed approximately \$6 million dollars to Second Avenue. On the first day of the case, the debtor filed a motion seeking interim and final approval for post-petition financing and use of cash collateral (the “Financing Motion”). In the Financing Motion, the debtor sought approval to borrow up to \$10 million in post-petition financing from Second Avenue to conduct the going-out-of-business sales and fulfill its obligations in chapter 11.¹ The Financing Motion seeks approval to pay Second Avenue’s pre-petition debt before paying its post-petition loan and to convert the pre-petition debt to a post-petition debt upon final approval. The Court approved the Financing Motion on an interim basis (the “Interim Financing Order”). Docket No. 29. The Court set a final hearing for August 28, 2019.

4. The debtor attached a budget to the Interim Financing Order. The budget included all projected revenues and expenses on a weekly basis through August 30 and then composite projections “post-sale” for the remainder of the case. The projections show that the debtor expects to pay Second Avenue in full on its pre-petition debt, post-petition debt, and attorney’s fees, leaving \$260,000 after costs of administration.

5. The budget, however, is misleading. The UST is informed that the projections do not include payment of any post-petition sales taxes, which based on the

¹ The Financing Motion and proposed order often refer to three entities, the “DIP Agent,” the “DIP Lenders,” and the “Prepetition Lenders.” For clarification purposes, the UST notes that all three are the same entity, Second Avenue.

projected \$13.5 million in sales could be in the \$1 million range. Instead, the UST is informed that sales taxes appearing as payments in the budget represent pre-petition amounts owed. Second, the budget does not include any payments to vendors under section 503(b)(9) of the Bankruptcy Code. Section 503(b)(9) provides sellers of goods with an administrative expense for any goods received by the debtor within 20 days of the filing of the case. The UST is informed that those 503(b)(9) claims are likely in the \$1 million range. If the debtor is unable to pay those claims, this case will be administratively insolvent.

6. Based on these numbers (which calculate to an approximate \$1.7 million deficit before considering any remaining assets), the case appears to be administratively insolvent. If that is the case, Second Avenue will recover \$6 million on its pre-petition claim during this case, while general unsecured creditors will receive nothing and other administrative claimants receive less than full payment.

Objections

7. **The Fees are too high:** The lender offers to provide a \$10 million revolving loan and charges a fee of \$200,000 for this loan. But the debtor had no need to borrow \$10 million. Instead, the \$10 million figure is used to artificially provide a bigger base on which to calculate Second Avenue's fee for its loan.

8. According to the budget, the debtor borrows the following sums:

Forecast Week	1	2	3	4	Total Through Sale	Post Sale
Retail Week	27	28	29	30		
Week Ending (\$ in 000s)	8/9/2019 Forecast	8/16/2019 Forecast	8/23/2019 Forecast	8/30/2019 Forecast		
DIP Loan						
Beginning DIP Loan Balance	6,019	5,395	3,176	223	6,019	(1,296)
Less: Collections	(1,851)	(3,772)	(3,882)	(4,027)	(13,533)	(1,620)
Plus: Interest and Fees	219	9	5	2	234	-
Plus: Net Funding Request	1,006	1,544	925	2,505	5,982	2,658
Ending DIP Loan Balance	5,395	3,176	223	(1,298)	(1,296)	(260)

9. The budget shows total borrowing of \$5,982,000 through the sale and \$2,658,000 after the sale. But the budget also shows that Second Avenue is actually paid in full at the end of sale (and actually overpaid by more than \$1.2 million).

10. Assuming the Court allowed Second Avenue to apply debt payments first to its pre-petition debt, by the end of the third week, the amount outstanding on the post-petition debt loan is only \$223,000. At this point, Second Avenue has lent the debtor a total of \$3,477,000. When Second Avenue then loans \$2,505,000 the week of August 3, the balance of the debt does not exceed \$3,477,000. Likewise, because the debtor has paid off the debt as of the close of the sale, any amount the debtor borrows post- sale will never exceed \$3.5 million. Thus, at most the debtor needed to borrow \$3.5 million.

11. If, on the other hand, the Court requires Second Avenue to apply any collections to its post-petition debt first, then the amount of the post-petition financing needed was much smaller. Because collections each week far outpaced the alleged net funding needs, the debtor never needed to borrow more than approximately \$1 million to perhaps \$1.5 million to fund this case.

12. Second Avenue requests a closing fee of \$200,000 for an alleged \$10 million borrowing line. Applying the same percentage (2%) to a \$1 million to \$1.5 million loan, the appropriate closing fee for this loan would be \$20,000 to 30,000. The Court should only approve the Financing Motion if the Closing Fee is reduced accordingly.

13. **The Court should not allow the Unused Line fee.** Second Avenue seeks to charge the debtor for an unused line fee. Second Avenue overstates the amount of the credit line needed, which artificially increases this fee. The Court should not allow Second Avenue to collect this fee.

14. The Court should not allow Second Avenue to apply payments to the pre-petition debt before the post-petition debt or convert its pre-petition debt to post-petition debt (the “Roll-Up”). Both the pre-petition debt and the post-petition debt accrue interest at the same rate. However, paying the pre-petition debt first allows Second Avenue to inflate artificially the amount of the necessary post-petition financing, for the benefit of Second Avenue and to the detriment of all other stakeholders in this case. The court should not approve the Financing Motion with this provision.

15. The request for a “roll-up” is likely a non-issue. If, indeed, the sales went according to budget, then the debtor will have paid off the pre-petition and post-petition loans by the time of the final hearing. However, if there is a shortfall, the Court should not elevate the pre-petition secured debt to post-petition status. As the Court’s Comments to Cash Collateral and DIP Financing Checklist in the Local Rules provide, “Liens granted in the cash collateral and DIP financing orders may not secure prepetition debts. Financing orders should not be used to elevate a pre-petition lender’s collateral inadequacy to a fully secured status.” L.R. Appendix L.-1020.1, Exhibit J, Comments to Cash Collateral and DIP Financing Checklist 3(a).

16. Avoidance actions: Second Avenue seeks a lien on all avoidance actions. Those avoidance actions were not pre-petition collateral of Second Avenue. Given the state of the case, the avoidance actions may be the only means to recover assets to pay creditors in this case. See also L.R. Appendix L.-1020.1, Exhibit J, Comments to Cash Collateral and DIP Financing Checklist 3(b) (“Avoidance actions in the event of a conversion to chapter 7 may be the only assets available to fund the trustee’s discharge of his or her statutory duties.”). The Court should not permit Second Avenue to take a lien

in these actions.

17. Indemnification Fund: Second Avenue Partners seeks to require the debtor to set aside a \$500,000 indemnification fund. Because those funds would come from Second Avenue, the debtor would have to pay interest for the borrowed money to set up that fund. The Financing Motion does not explain why this fund is appropriate or necessary. The Court should not approve this term as part of the post-petition financing.

18. Surcharge: The proposed order provides that the court may not surcharge Second Avenue's collateral under 11 U.S.C. § 506(c). As the Court has stated in its Comments to Cash Collateral and DIP Financing Checklist attached to its Local Rules, limitations on the surcharge of a lender's collateral are disfavored. The Court accurately states that since "the burden to surcharge requires a showing of direct benefit to the lender's collateral, lenders are not unreasonably exposed to surcharges of their collateral." L.R. Appendix L.-1020.1, Exhibit J, Comments to Cash Collateral and DIP Financing Checklist 3(c). Moreover, only the debtor-in-possession or a chapter 7 trustee can recover under 11 U.S.C. § 506(c). *Hartford Underwriters Ins. Co. v. Union Planters Bank*, N.A. 120 S. Ct 1942 (2000). The Court should not approve this provision.

WHEREFORE, upon the premises considered, the UST respectfully requests that the Court deny approval of the Financing Motion unless the debtor and Second Avenue agree to change the terms of any final order as set forth above and for such other and further relief to which it may be entitled.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Objection has been served on all the parties on the attached Service List either electronically through the Court's CM/ECF system or by first class mail on this the 23rd day of August, 2019.

/s/ Kevin M. Epstein
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